The Nation and The Athenæum
Life Assurance Supplement

CONTENTS

THE INVESTMENT POLICY OF LIFE OFFICES

By C. R. V. COUTTS, Manager and Actuary of the Provident Mutual Life Assurance Association.

UNTIL recent years very little attempt has been made to formulate principles which should guide those responsible for Life Assurance Finance. There is an instinctive prejudice in this country against the application of logical thought to practical affairs. Mr. Chamberlain expressed this habit of mind in a recent speech in the House of Commons when he said, "I profoundly distrust logic when applied to politics, and all English history justifies me." Consequently, before the War the nearest approach to a principle that would have met with any general acceptance was a dictum made by Mr. Bailey in 1862, that security should be the first consideration, and that the rate of interest should be subordinate to the security of the capital. Even this principle was not, in fact, rigidly applied, because to hold any investment giving a higher yield than British Government Securities would, to that extent, be to sacrifice some degree of security. Still more primitive was the principle adopted by one of the larger British Life Offices, which, when it had funds available for investment, invited three stockbrokers to submit lists of securities which, in their opinion, were suitable, and purchased any one which appeared in all three lists.

From almost every point of view the War was an unmitigated disaster to the business of Life Assurance. But though claims were increased and expenses went up, it was the investments that bore the brunt of the loss. When it was realized that though some forms of capital, as *e.g.*, Gilt-Edged Stock Exchange Securities, suffered a severe and continual loss of value, other categories of capital, such as land and house property, actually rose in value, and that the capacity of a Life Office to pay a bonus might depend, *e.g.*, on whether it invested its funds in Three Months Treasury Bills or Long-Term War Loan, it became evident that an investment policy was not merely a matter of theoretical speculation, but one of great practical importance. For though the War and its after-effects magnified and concentrated in a comparatively short period of years fluctuations in the value of various forms of capital, it is now realized that even in normal times they do occur, but more gradually and spread over longer intervals.

On this question of investment policy there are, broadly speaking, two schools of thought: the one endeavours to safeguard the Office from risks arising out of fluctuations in value; the other seeks to profit by them. The former may be called the policy of "Economy of Risk" and the latter that of "Market Profit." It is, of course, possible to give here only a brief outline of these two policies.

A.—ECONOMY OF RISK.

Advocates of this policy start with the premiss that no investment should be made without due regard to the purpose to be achieved. What, then, is the purpose of Life Assurance Investment? It is, surely, to enable the Office to meet the liabilities for which it contracts under its policies. The contracts of Life Offices differ from those of other financial corporations in two essential features. The first is that in return for a fixed contribution, which cannot be varied however financial conditions may change, a Life Office undertakes to pay a sum of money at an uncertain date which may be many years hence. The second is that the Life Office calculates the contributions or premiums charged to its policy-holders on a basis which assumes that it will be able to invest the funds accumulated out of these premiums at a definite rate of compound interest. A Life Office has therefore to invest the premiums it receives, not merely to secure the highest return that can be obtained for the time being, but also as far as possible to guard against changes in financial conditions in the future by securing the maintenance of the interest return for such terms as are likely to cover the duration of existing contracts. Again, on the maturity of the contract, a Life Office has to pay out a fixed sum of money, and cannot therefore discharge its obligations without having regard to the ultimate capital value of its investments. The policy, therefore, of "Economy of Risk" applied to the business of Life Assurance demands a scheme which shall, as far as possible, eliminate in the first place the risk of loss from a fall in the general rate of interest in the future, and in the second place the possibility of a permanent loss of capital value. An Office therefore will satisfy these criteria by investing its funds (*a*) at a rate of interest adequate to that assumed in its premiums, (*b*) in securities which will ultimately be redeemed at a fixed price, (*c*) the dates of redemption of which are distributed over a period corresponding approximately with the maturity of its own contracts.

B.—MARKET PROFIT.

Though the original function of Life Assurance was to provide a protection against the loss caused by death, such developments as Endowment Assurances and other forms of Investment Assurance have introduced another function which, at the present day, is becoming more and more important. Apart from providing cover against the risk of death, a Life Office provides an organization which enables the small investor to invest his savings collectively under skilled advice, and to obtain the advantages that accrue to those who make investments on a large scale. It is from this latter point of view that the advocates of the "Market Profit" policy approach the problem. As custodians of the savings of their policy-holders they regard it as their duty to invest the funds under their control to the best advantage for the time being, leaving perhaps rather in the background the special character of the liabilities which have ultimately to be met. It is claimed, for example, that by a scientific study of financial and

industrial conditions throughout the world the upward and downward trend of market prices of investments can be foretold with a high degree of accuracy. On this theory, during the period when fixed-interest investment stocks generally are expected to rise, the whole of the funds will be kept in long-dated or irredeemable investments, thus securing the maximum appreciation in capital value. On the other hand, when a turn in the tide has been forecast, the profit obtained on the long-dated securities will be realized and the fund rapidly transferred into short-dated securities. By this means the funds of the Office will not suffer depreciation at a time when the prices of permanent securities are falling. If this argument were pressed to its logical conclusion the Office in question, instead of merely avoiding depreciation, might secure a greater return on its funds by investing in ordinary stocks or shares, or in commodities themselves during the period when fixed-interest securities are falling in value, and therefore, by the ordinary credit cycle argument, trade is booming and prices of commodities are rising. But this is perhaps a stage further than the advocates of the "Market Profit" policy are prepared to go at present.

CAN THE TWO POLICIES BE COMBINED?

So far no reference has been made to the dual character of the contract involved in an ordinary with-profit policy. If a policy-holder pays a premium of £100 per annum under a with-profit policy he, in effect, makes two separate bargains with the Office. Out of each £100 about £75 is required to enable the Office to pay the sum assured when it becomes due. The balance of £25 is historically a margin to meet the possibility that the mortality, &c., may work out differently from the basis assumed in calculating the premium. It is still available as a margin to meet abnormal losses such as those created by the War. But in normal times this additional £25 a year is paid by the policy-holder to obtain the right of partnership in the prosperity of the Office, and with no definite obligation on the part of the Office to make any specified payments in return. We have, therefore, in a with-profit policy two contracts, the one absolutely rigid and defined, corresponding roughly to a debenture in a company, the other quite fluid and uncertain, corresponding to an ordinary stock or share.

The funds of an Office can therefore be divided into two parts. The one represents the accumulations of about three-quarters of the with-profit premiums and the whole of the non-profit premiums, which are necessary to enable it to meet its legal liabilities. The other represents the accumulations of the margins of the with-profit premiums (which are approximately the remaining quarter not carried to the first fund), in respect of which there are no rigid liabilities at all, and which it can therefore employ with absolute freedom to the best advantage of its policy-holders.

If the former part be called the Assurance Fund and the latter the Profit Fund, it would seem reasonable that the Assurance Fund should be invested strictly on the principle described as "Economy of Risk," whereas the Profit Fund might in this case quite properly be invested on the principle described as "Market Profit," under which it is assumed the policy-holder would obtain the fullest advantage of the financial conditions which may prevail from time to time, without the necessity of looking ahead to the maturity of the contracts which, by hypothesis, are provided for by the Assurance Fund.

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X.Y.Z. effected in 1880 a policy for £500 payable at death, his age being 29 and the annual premium being **£11 15 5.** At the end of 1923 he had paid a total of **£517 18 4** while Reversionary Bonuses to a total of **£665 18 0** had been added to the sum assured. The total amount of his cover was therefore **£1165 18 0.** The Reversionary Bonuses had a cash value of **£478 12 10.** It will be observed that the increase in the sum assured by bonuses exceeded the premiums paid by **£147 19 8.**

This is an actual example and is obviously affected by the special circumstances of the War. It should be noted that the Society is now distributing larger bonuses than before the War.

The following Schedule shows clearly the remarkable progress in the Society's bonus declarations in the post War years.

Year	Cash Surplus Divided		Reversionary Bonus
	Amount	Percentage of Premiums Paid	
1919	£1,207,934	37.7	£2,070,000
1920	1,336,402	38.5	2,273,000
1921	1,502,572	42.4	2,562,000
1922	1,756,738	47.3	3,000,000
1923	1,987,289	50.9	3,350,000
1924	2,223,786	52.9	3,800,000

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W. C. Fisher, *Manager for the United Kingdom.*

RECENT DEVELOPMENTS IN INSURANCE

By GEOFFREY MARKS,
Past-President of the Institute of Actuaries, Actuary and Manager of the National Mutual Life Assurance Society.

THERE has been a great stirring in the dry bones of insurance in the years since the war, and the noise of their shaking as they come together, "bone to his bone" in each species, has excited unusual attention wherever insurance is a matter of interest or importance—which, were it realized, is equivalent to saying throughout the world and in all the relations of life, whether business or social. Few people appreciate to the full the character and extent of the risks which can be met by insurance, outside the ordinary ones of fire, life, marine, and accident. With such insurances as motor-car, burglary and accidental loss, boiler, live-stock, hail, fine weather, consequential loss (*e.g.*, of rent, due to fire), most citizens are acquainted either from personal knowledge and experience or as the result of clever and persistent advertising. That the prospective father can prudently provide for the payment of a sum of money on the birth of twins is also well known. But there are more remote risks which will be covered either by the big companies or by the enterprising underwriters at Lloyd's. Of these may be mentioned the loss or recovery of sanity, the failure to make a will or the alteration of one already made, a change of name and arms, and the dying with or without legitimate issue, and married or unmarried—and the list is not exhausted. These possibilities have been mentioned to show the extent of the field in which insurance works, and yet no mention has been made of the great schemes of national insurance—health and unemployment—of which the former has developed into a powerful organization for good, whilst the latter, as the result of political scheming and timidity, has degenerated into an almost equally powerful machine for ill, and has lost in the process nearly every characteristic of insurance.

Strictly speaking, no one of these developments belongs entirely to the post-war period, not even unemployment insurance, although all that is harmful and dangerous in it has grown up within the last four or five years. Credit insurance is another form of beneficent enterprise, which had its origin some twenty-five or thirty years ago, but of which the extension and improvement are recent, and are due mainly to the persevering skill and courage of two men—Mr. Cuthbert Heath of Lloyd's and Mr. H. S. Spain. Credit insurance, though it requires special qualities and technical knowledge of the highest kind, is destined to be of great value both to home and to foreign trade. This is recognized by the big general insurance companies, who have quite recently arranged to devote some part of their huge resources to its development. Put very shortly, credit insurance provides that the company granting the cover shall share with the trader, in proportions varying with the circumstances, the risk that the latter's customers may fail to fulfil their financial obligations towards him. The value of this support, even in the somewhat limited form in which it is at present possible to give it, is obvious in the conditions which now exist, and must become greater as experience is enlarged and the outlook for trade, both national and international, becomes clearer.

Somewhat in the same kind as the insurance of private credit is the insurance of the credit of foreign States and other bodies, or of the Governments of our own Dominions. Contracts with this object provide against the failure by the borrower to meet in full, and when due, the principal and interest payable under loans publicly issued. As a rule policies of this kind are limited in their application to loans which are falling due within a comparatively short period.

IS YOUR INCOME SAFE ?

Dividends have a habit of crumbling. No matter how carefully you arrange your investments, you can never be sure that next year will not find you worse off than you are to-day.

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Write to-night (stating age) J. R. Wandless,

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There is much to excite interest in other directions. The fraud of the Bevan companies and the failure of some others, founded in haste and developed with more regard to size than to safety, gave rise to a feeling that the powers of the Board of Trade to intervene when suspicion was justified, but before disaster actually happened, were insufficient, and were liable to be defeated by an unscrupulous use even of the limited freedom which the companies enjoy under the Assurance Companies Act, 1909. As a result, the Board appointed a Departmental Committee, which is still taking evidence, to inquire into the working of the Act and to make recommendations. Important points have already been brought out, and the report of the Committee is anticipated with much interest, and no doubt in certain quarters with some trepidation.

Further evidence of the interest of the State in insurance as affecting the rights and welfare of the public is afforded by the passing of the Industrial Assurance Act, 1923, as a consequence of a public inquiry previously held. The Act came into force on January 1st, 1924, and has already been productive of much good. It should be mentioned that certain of the more important companies affected had voluntarily adopted some of the provisions of the Act before it was passed, and that in regard to others a period of grace is given, during which it is hoped that most companies will be able to put themselves in a position to comply with all its requirements. One of the immediate results of the Act (or possibly of arrangements made in anticipation of its passing) has been a considerable reduction in the expense of transacting the business of industrial assurance. In the case of the great Prudential Company the reduction is especially remarkable, although it is known that the far-sighted management of that Company had taken steps towards this end even before the war. Possibly, it is not common knowledge, although it is a notable achievement and therefore worth mentioning, that the Insurance industry was the first, and at the time the only, industry to set up its own special scheme of unemployment insurance under the Act of 1920. The fact is mentioned here because no one who has had experience of the internal working of the scheme can fail to realize how greatly the scheme and the whole industry would benefit if other companies and societies would follow the example of the "Prudential" in stabilizing employment on their agency staffs. The methods of recruiting, working, and dismissing agents are extraordinarily wasteful, and in many cases scandalously bad.

Many difficult problems have arisen, particularly in life assurance, as a result of the abnormal conditions which arose during the war and in the years which have followed it. But these problems are the result not of adversity, but of a somewhat too exuberant prosperity. That the insurance industry as a whole has enjoyed exceptional success is shown by the remarkable rise in the market valuation of the shares of the companies engaged in it. The "Stock Exchange Gazette" has published figures which show that between the end of December, 1923, and of February, 1925, the market valuation of the shares of thirty representative companies had increased by nearly 30 per cent. The rise has been accompanied by some advance in dividends, but the yield on the shares is now, as it always has been, a very low one. In certain cases capital distributions to shareholders have been made in various forms, but insurance managements are chary of such favours, and shareholders generally have to be content with little, and in some cases nothing more than the interest on invested funds which is not otherwise appropriated.

The life-assurance companies and mutual societies are on the crest of a wave of prosperity. During the war a conservative policy was adopted, and all but a very few offices made no distributions of bonus. From 1918 onwards there has been on the whole a rapid increase in capital values, while the yields from interest, although diminishing, have consistently shown a wide margin over the rates used in valuing the offices' liabil-

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ities. The result has been to unsettle or upset many preconceived ideas as to financial policy, the distribution of profit, and methods of valuation.

A chance expression in the speech of the chairman of a mutual life office introduced into current use the phrase " active finance." Round this and the ideas which it expresses or is assumed to express a considerable controversy has raged ever since—"*actuarii certant et adhuc sub judice lis est.*" Certain of the misconceptions which quickly clustered round the phrase have been dispersed, but there are still some critics who seem disposed to maintain that profits made from the purchase and sale of securities are in some sense illicit and not to be regarded as profits, or at least not as divisible profits, and that the interest yield is the only true test of success in financial management. To others it may seem that the two views are but different aspects of the same problem, and that success will follow those who can keep a watchful eye on each of them.

But all the offices, no matter what their policy has been, are now showing larger surpluses than in the past, and conscientious boards and managers are worried by the thought that possibly the old methods of division, although well adapted to the slow progress which was the usual form of change in pre-war days, are not equally suitable or equitable when applied to an abnormal surplus amassed during a few years. How much of such a surplus should be reserved for existing policyholders, and particularly for those who got nothing during the war? Can any system of distribution provide a strictly equitable apportionment between the oldest policyholder and the most recent entrant? If only a limited distribution is made, how can the undivided surplus be protected against the raids of new policyholders, or the possible megalomania of a changed board and management?

The difficulty implied in the first of these questions has been met, if not solved, by certain offices in different ways, none of which are free from objection. Other offices have decided that it is inadvisable, if not impossible, to reopen the past, and that if it could be done the difficulties of an equitable readjustment of interests are insuperable, and would lead to additional complications in the future. To answer the other questions has required a re-examination of the whole system on which the business of life assurance is now conducted, and a reconsideration of the generally accepted methods of valuing a company's liabilities. It would be impossible here to discuss these points in detail, but, in view of the heavy cost of new business, and particularly of small policies, one office at least has decided to impose a limit of £500 as a minimum for new policies. Larger limits are already required by some offices for non-profit policies, and the decision quoted is not unreasonable in face of the statement by the office concerned that the cost of placing on the books ten policies of £100 is more than six times that of one policy for £1,000.

In considering methods of valuation attention has been redirected to that known as the " Bonus Reserve " method. A full technical description of the method would be inappropriate here, but it may be said that it is a gross premium method, which takes account of the rate of interest actually earned, the rate of expense actually incurred, and the rate of mortality likely to prevail. Its most distinctive feature is that it treats as a liability and makes a reserve for the rate of bonus which it is expected to maintain during the currency of all with-profit policies in existence at the date of valuation. It is thus the only method which attempts to determine at all accurately the proportions in which ascertained surplus should be distributed and carried forward. On any revision of the Assurance Companies Act, 1909, a much wider discretion as to the methods of valuation to be used should be allowed to the offices, subject to a complete explanation of the processes employed being given to the public. There are, for example, several short methods of valuation which, though called " approximate," cannot properly be said to be any less correct than those which profess to be accurate. In these days of annual valuations such methods should be permitted as saving both time and labour.

BAIT

THE inevitable thing about " Options ", " Guaranteed Bonuses", " Investment Policies with return of premium on death and half your rent paid for you", and so on, is that what should be a perfectly simple affair has become a decidedly complex business. There is an unnecessary straining to invent some gimcrack policy which will attract the public eye. Just " bait " and nothing more. All *special* benefits are bait. They cost money and are paid for by the victims.

NO thoughtful man should be "caught" for life assurance. Rather should he take out a policy deliberately after giving careful consideration to the matter, and coming to a reasoned decision.

IN its simplest form life assurance is a protection to a man's family against the financial disaster which death involves in varying degrees.

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THE AMOUNT OF SUM ASSURED AND BONUSES OBTAINABLE IN THE PRINCIPAL LIFE OFFICES FOR AN ANNUAL PREMIUM OF £10.

INASMUCH as the following table shows what each Office offers for a given annual premium, it appears to us to provide a fair means of comparing one office with another. The estimated amounts of the sum assured and bonuses are based on the assumption that future bonuses will be maintained throughout the period of assurance, either at the last declared pre-war rate of bonus, or at the latest declared rate, whichever is the greater.

A note has been made where exceptional bonus declarations have been accompanied by a statement that it is not to be expected that they will be maintained.

The British Life Offices have not only passed through the War period practically unscathed, but they are to-day in a position of exceptional strength with greatly improved bonus prospects. For this reason it is felt that the assumption referred to above is fully justified. At the same time it must be borne in mind that the figures given in the table are estimates only and cannot be guaranteed.

Office.	Endowment Assurance.		Whole Life Assurance.
	Age at entry 30 next b'day.		Age at entry 30 next b'day.
	Age at maturity 55.		Age at death (assumed) 65.
		£	£
Abstainers and General	General Section,	342	648
,, ,, ,,	Temperance ,,	359	745
Alliance		370	720
Atlas (*a*)		384	750
Australian Mutual Provident		433	986
Britannic		372	712
British Equitable		353	691
Caledonian		363	647
Canada Life		370	708
Clerical, Medical, and General		357	699
Colonial Mutual		409	781
Commercial Union		364	653
Co-operative Assurance		349	644
Eagle Star and British Dominions	General Section,	333	613
,, ,, ,, ,, ,,	Temperance ,,	319	564
Equitable		375	719
Equity and Law		357*	649*
Friends Provident and Century		382	762
General		331	614
General Accident		348*	621*
Gresham		326*	550*
Guardian		361*	654
Law Union and Rock		426	871
Life Association of Scotland (*a*)		362	659
Liverpool and London and Globe		352	647
London and Scottish		308	554
,, Assurance		362*	676*
,, Life		404	793
Marine and General		375	697
Motor Union	General Section,	345	625
,, ,,	Temperance ,,	361	660
National Mutual		426	856
,, Provident		363	678
National Mutual of Australia		418	879
North British and Mercantile (*b*)		354*	665*
Northern (*a*) (*c*)		377	629
Norwich Union (*a*)		364	696
Pearl		357	694
Phœnix		354*	652*
Provident Mutual		358	663
Provident Association		351	659
Prudential		356	687
Refuge		372	690
Royal		343	626
,, London		334	616
,, Exchange		348*	654*
Scottish Amicable		369*	694*
,, Insurance Corporation		350	635
,, Equitable		359	Premiums cease 658 at age 75
,, Life		361*	680*
,, Provident (*d*)		378	708
,, Temperance and British General	General Section,	370	694
,, ,, ,, ,,	Temperance ,,	363	785
,, Union and National		340	610
,, Widows (*e*)		375*	694*
Standard		356	666
Sun (*f*)	General Section,	352	640
,,	Temperance ,,	361	673
Sun Life of Canada		361	675
United Kingdom (*f*)	General ,,	372	723
,, ,,	Temperance ,,	381	760
Wesleyan and General		369	707
Yorkshire	General Section,	363	673
,,	Temperance ,,	366	687

* In these cases the last pre-war rate of bonus has been assumed in making the calculations.

(*a*) The figures for these Offices have been based on the rate of interim bonus which has recently been declared.

(*b*) A special compound reversionary bonus of £3 10s. 0d. per annum for years 1921-1922 was declared at December 31st, 1922. The Chairman stated at the Annual Meeting : " We are never likely to declare so large a bonus again."

(*c*) A special bonus of 55s. per cent. per annum in respect of the three years ending December 31st, 1923, was recently declared. It is pointed out, however, in the Annual Report, that this must not be taken as a normal rate of bonus, and consequently it would not be proper to base thereon any estimate as to what the future bonuses on policies are likely to be.

(*d*) Whole Life Policies, sharing profits when the premiums, if accumulated at 4 per cent., would amount to the sum assured.

(*e*) The rate of bonus declared for the five years 1919-23 was at an exceptional rate and a repetition of it is not to be expected. The rate of intermediate bonus at present being allowed under Claims, *viz.*, 35s. per cent per annum compound, has been assumed in making the calculations.

(*f*) A special bonus was given to old policyholders at the last valuation.

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JUST OUT

The Main Currents of Social & Industrial Change, 1870-1924

BY

T. G. WILLIAMS,
M.A., F.R.Hist S., F.R.Econ. S.

¶ The purpose of this book is to outline the growth of Society, Industry and State during a period of wonderful advancement

The most prominent features of the half century under review in this book are the extension of the power and functions of the State, the broadening of the franchise, the beginnings of democratic control of industry, and wonderful achievements of science and technology. The author traces the history of the changes brought about during this period, keeping in mind the requirements of the inexperienced but intelligent student.

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AN AMERICAN STUDY OF SHARES *Versus* BONDS AS PERMANENT INVESTMENTS*

By J. M. KEYNES.

THE author of this interesting little book set out on his inquiry with the idea that, whilst it was to be expected that an investor in Common Stocks would do better than an investor in Bonds during a period of rising prices, yet the opposite would probably be true during a period of falling prices. To test this he embarked on a series of investigations to trace the history of the two classes of investments over different periods between 1866 and 1922, selecting his sample lists of securities by various objective tests, such as those which were most actively dealt in at the date of investment;—thus keeping to the best-known companies, in which an intelligent investor would have been most likely to invest at the dates in question, and avoiding any bias of the kind sometimes known in this country as "jobbing backwards," that is to say, the selection of investments in the light of subsequent events.

The results are striking. Mr. Smith finds in almost every case (in ten tests out of eleven), not only when prices were rising, but also when they were falling, that common stocks have turned out best in the long run, indeed, markedly so; whilst in the odd case there was not much to choose between the two. Having got so far, he applied a more rigorous criterion. Were the superior average results obtained at the cost of an inconvenient irregularity of income as between one year and another? On the contrary, he found that, even in the worst years, his index of ordinary shares gave, almost invariably, a better yield than his index of standard bonds.

This actual experience in the United States over the past fifty years affords *primâ facie* evidence that the prejudice of investors and investing institutions in favour of bonds as being "safe" and against common stocks as having, even the best of them, a "speculative" flavour, has led to a relative over-valuation of bonds and under-valuation of common stocks.

It is dangerous, however, to apply to the future inductive arguments based on past experience, unless one can distinguish the broad reasons why past experience was what it was. Otherwise there is a danger of expecting results in the future which could only follow from the special conditions which have existed in the United States during the past fifty years. Mr. Smith claims that the general causes for the relative advantages of common stocks are discoverable, and that they are of a kind as likely to operate in the immediate future as in the immediate past. I may summarize these causes, expressing some of them in my own way and some of them in his, as follows:—

(1) An investment in Common Stocks is an investment in real-values. An investment in Bonds is an investment in money-values. Obviously there are advantages in the former, if the long-period trend of the value of money in terms of goods is downwards; and also contrariwise. Nevertheless, there is a presumption in favour of real-values over money-values: firstly, because the value of money can, in certain circumstances, fall indefinitely, as has happened in Europe since the war (and in the light of past history this is an appreciable risk against which it is worth while to be safeguarded), whereas a corresponding rise is out of the question; secondly, because, quite apart from catastrophes, the classes in the community who benefit from a falling value of money are stronger than those who benefit from a rising value,—"All lenders of money, particularly bondholders, favour an appreciating currency. No other class is always actively in favour of an appreciating currency. In theory they all believe in sound or stable currency, but each, in his efforts to widen the margin of profit that he makes in relation to profits in other lines, at times subscribes to activities which tend towards depreciation" (p. 88).

(2) Even in the most carefully selected list of bonds, one or other of them will occasionally go wrong. But whilst the possibility of default cannot be ruled out, no bond ever pays *more* than the stipulated rate of interest. Thus there can be no exceptional successes to average out with exceptional failures. The purchaser of a selection of common stocks can afford to make an occasional mistake; the purchaser of bonds cannot. In other words, the actual average return from bonds, after allowing for unavoidable losses, is always somewhat less than the apparent average rate of interest at the date of investment.

(3) The "Human Factor" in the management of the companies concerned favours the shares. "The management of every company is on the side of the common stock and opposed to the interests of the bondholders. The management does not want the bondholders to get more benefit from the operation of the company than is absolutely necessary to make it possible for the company to sell more bonds if such additional sale of bonds can be made to show a profit to the stockholders" (p. 85). In particular, the management will avail themselves of their rights to repay bonds at dates most advantageous to the shareholders and most disadvantageous to the bondholders.

(4) "In buying bonds, the investor agrees that the issuing companies may retain all earnings over and above the income return which he has agreed to accept. He establishes no reserves of his own, and relinquishes all title to the reserves that are established for him. Such reserves, while protecting his income, accrue to the benefit of the stockholders of the companies whose bonds he holds. The purchaser of a bond is an investor, but he exercises none of the functions of investment management with regard to his invested funds. He pays the corporation which issues the bonds a substantial sum for exercising this function for him, and a survey of the prices at which bonds in different industries sell discloses the fact that he pays on the average more for this service in those industries whose stabilized earnings call for the least responsibility on the part of the issuing companies" (pp. 114, 115).

(5) I have kept until last what is perhaps Mr. Smith's most important, and is certainly his most novel, point. Well-managed industrial companies do not, as a rule, distribute to the shareholders the whole of their earned profits. In good years, if not in all years, they retain a part of their profits and put them back into the business. Thus *there is an element of compound interest* operating in favour of a sound industrial investment. Over a period of years, the real-value of the property of a sound industrial is increasing at compound interest, quite apart from the dividends paid out to the shareholders. Thus whilst an index of bonds yields, as we have seen, *less* in the long run than its initial apparent rate of interest, an index of shares yields *more* in the long run than its initial apparent rate of interest. So far, therefore, from the higher apparent rate of interest on shares, as compared with that on bonds, being required to compensate the greater risk of loss, the reverse is true. Shares work out better than bonds by more than the difference between the apparent rates of interest upon each.

Mr. Smith has made an estimate of what this element of compound interest has amounted to upon the average. He finds that over a long period the average rise in market value of typical common stocks is approximately equal to the value which would have accumulated on the assumption that the concerns set aside annually out of current profits a sum equal to $2\frac{1}{2}$ per cent. of their capital, and retained these sums to fructify in the business. This

* "Common Stocks as Long-Term Investments." By Edgar Lawrence Smith. Pp. ix+129. (New York and London: Macmillan. 6s. 6d.)

figure is not inconsistent with what one knows as to the actual practice of conservative business. But the effect of this accumulation over a period of years is, like all compound interest effects, of startling magnitude. It is sufficient to recoup after a moderate interval even those investors in common stocks who were so imprudent or so unfortunate as to make their initial investment at the top of a boom.

Mr. Smith applies one final test of comparative advantage which is the most overwhelming of all. He assumes that the ultra-prudent investor forms an investment reserve out of the surplus income of common stocks, as compared with that of an equal initial investment in bonds, regarding as income only that amount which he would have received from bonds and reinvesting the balance in additional shares. In this case the capital appreciation of his holding over a period of about twenty years varies from 104 per cent. in the least favourable case to 355 per cent. in the most favourable case—a calculation which certainly provides a big margin against the unexpected.

In working out his principles of investment, Mr. Smith has not, particularly, in mind such institutions as insurance companies. Indeed, rather the contrary. He points out (p. 11) that, since the liabilities of an insurance company are fixed in terms of money, its criteria for safe investment must be somewhat different from those of other investors, and in particular that such a company has nothing to fear from the depreciation of money,—" The purchasing power of future dollars is of no concern to it. If dollars have shrunk in value, the beneficiary under its policies absorbs the shrinkage, the company does not." This may have an important application to proprietary companies where the policy-holders are not interested in profits. But its application to Mutual Life offices, for example, is, I think, very limited. In the case of these offices the object of the management must be to invest the funds to the best advantage of the members, subject to special care as to the absolute safety of the amount of the guaranteed policy. It would be poor consolation to the holder of a mutual with-profits policy, expressed in terms of francs, to know that the Board have limited their attention to ensuring that he should receive at the maturity of his policy its full value in francs as stipulated before the war. If it is true that debentures are relatively over-valued, this is a conclusion of the highest interest and importance to those responsible for the investment of insurance funds.

It is unlucky for us in this country that Mr. Smith's inquiry relates exclusively to American investments. It would be of great interest to know the results of a similar investigation applied to British investments. I have the impression that it might not turn out quite so favourably to ordinary shares, partly because our businesses have, for obvious reasons, not gone ahead at quite the same pace, and partly because American industrial concerns may have been rather more conservative than ours in the division of profits. I do not feel confident that the compound interest element would work out so high as 2½ per cent. per annum in the case of British ordinary shares. In any case, it is much to be hoped that the investigation will be made. It is not a particularly easy one to carry out. There is the initial difficulty of selecting a suitable index; and there is the recurrent difficulty of valuing bonus issues and other valuable "rights," which are given to shareholders from time to time. Mr. Smith puts emphasis on the importance of attending carefully to the latter, and points out that most charts of the values of ordinary shares over a long period are seriously vitiated on account of their compilers' slackness about this. But these difficulties are not insuperable, and the work would be of high educational value to anyone who aspires to understand ordinary shares. Will not the investment department of one of our great Insurance Companies put the work in hand? It is a task well adapted to the training and mentality of actuaries, and not less important, I fancy, to the future of the insurance industry than the further improvement of Life Tables.

UNITED KINGDOM PROVIDENT INSTITUTION.

For the years 1921-1923 the above Institution allotted Reversionary Bonuses at the rate of from 35s. to 38s. per cent. per annum on Sums Assured and existing Bonuses, the higher rates being allotted to Total Abstainers. Interim Bonuses for the current Triennium are at the same rate.

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FRIENDS' PROVIDENT & CENTURY LIFE OFFICE.

The Annual General Meeting of the above company was held on Wednesday last at the Holborn Restaurant, London.

Mr. Alfred Holmes (the Chairman) said: The sums assured, after deducting reassurances, for the valuation period were £6,177,000, with new premiums of £377,000. Of these totals, 1924 accounted for £1,383,000, with corresponding new premiums of £160,000. The amount of the claims paid during the quinquennium was 61 per cent. of the sum expected.

During the valuation period the life premium income has increased by £247,000 and the life and annuity fund by £1,167,000. The net interest income, after deduction of income-tax, has advanced by £118,000. The aggregate of the increases in the various funds was £390,000 in 1924.

CENTURY INSURANCE COMPANY, LIMITED.

As the result of the quinquennial valuation, a highly satisfactory rate of bonus was paid to the with-profit policyholders. £15,710, being the shareholders' proportion of the distributed surplus, was transferred to profit and loss account; £44,000 undistributed surplus was carried forward. In the fire account the premium income increased by £5,000. The net trading profit was £30,349.

The marine premiums of £85,000 were slightly less than in the previous year.

The accident and general account also includes employers' liability, and a considerable increase in income was secured—namely, £30,000, making the total £146,000. The claim ratio was 49.9 per cent.

The profit and loss account balance of £34,000 brought forward from 1923 has been augmented by profits transferred from the accounts already dealt with, and further increased by £11,412 net interest. There remained a balance of £91,181, of which £65,625 has been utilized in payment of dividend, free of income-tax, for the four years 1921-1924, and the balance of £25,556 carried forward.

The paid-up capital is now £210,000, and there remains the sum of £105,000 at call. Apart from this addition to liquid resources the departmental funds (including profit and loss) increased by £46,000.

FRIENDS' PROVIDENT BALANCE-SHEET.

An addition of £53,400 has been made to the reserves in respect of existing annuity contracts by valuing them on the basis of the new life annuitants' tables recently published. The surplus shown as the result of the valuation was £464,326, of which £36,665 had been paid as intermediate bonuses to members during the valuation period.

It was decided to carry forward £24,402 unappropriated and to divide amongst the members the sum of £403,259. This has been sufficient to provide a bonus on whole-life endowment assurances at the rate of £1 16s. per cent. on the sum assured, including existing bonuses in respect of each year's premium paid during the quinquennium.

The report and accounts were unanimously adopted.

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